
Regional Outlook

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FDIC MEMPHIS REGION



DIVISION OF
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A Message to Our Readers

The FDIC community extends its deepest sympathy to the families, friends, and co-workers of the victims of the attacks on September 11, 2001.

The articles in this edition of the *Regional Outlook* were prepared before the tragic events of September 11. We will assess the implications of these events in future issues of the *Regional Outlook*. The public can rest assured that deposit insurance is in full force—money is safe in an FDIC-insured account.

Regional Perspectives

◆ *Community Bank Earnings Performance Stumbles in the First Quarter*—Net interest margins, a vital component of community bank earnings, fell to the lowest level reported in 17 years. Further economic slowing could contribute to additional earnings erosion. *See page 3.*

◆ *Consumer Loan Portfolios Weaken as the Economy Slows*—A growing consumer debt burden and numerous layoffs in the stressed manufacturing sector in recent quarters may lead to an increase in consumer delinquencies and loan losses, particularly among the Region's rural banks. *See page 4.*

◆ *Banks and Thrifts in the Region's Metropolitan Areas Are Vulnerable to Residential Real Estate Market Oversupply*—Relatively high levels of credit exposure and a slowing economy have already affected the credit quality of construction loan portfolios at Memphis area banks. *See page 7.*

By the Memphis Region Staff

In Focus This Quarter

◆ *Slowing Economy Reduces Demand for U.S. Office Space*—A slowing economy has contributed to softening in many U.S. office markets during the first half of 2001. The office vacancy rate has recorded the largest six-month increase in the past 20 years. A combination of trends—a substantial drop in demand for office space and an uptick in construction activity in some markets—has led to this slackening.

This article reviews recent developments in U.S. office markets and describes demand-side and supply-side trends that have contributed to the recent weakness. It notes the role played by the changing fortunes of high-tech firms in a number of U.S. metro areas and how this situation has contributed to large increases in the volume of space available for sublease. Finally, the article focuses on the local construction and commercial real estate loan exposures of FDIC-insured banks and thrifts that have the task of managing their risks under changing market conditions. *See page 11.*

By Thomas A. Murray

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Regional Perspectives

- Banks and thrifts in the Memphis Region reported sharply lower earnings because of declining net interest margins and rising provisions for loan and lease losses. Further economic slowing could lead to additional earnings erosion because of declining loan volumes and rising nonperforming assets.
- Consumer loan portfolios have weakened as the Region's economy has slowed. A growing consumer debt burden and numerous layoffs in recent quarters may lead to higher consumer delinquencies and loan losses.
- Banks and thrifts in some of the Region's metropolitan areas report relatively high construction loan exposure and may be vulnerable to residential real estate market imbalances. Credit exposure levels and current market imbalances appear to be greatest in the Memphis metropolitan area.

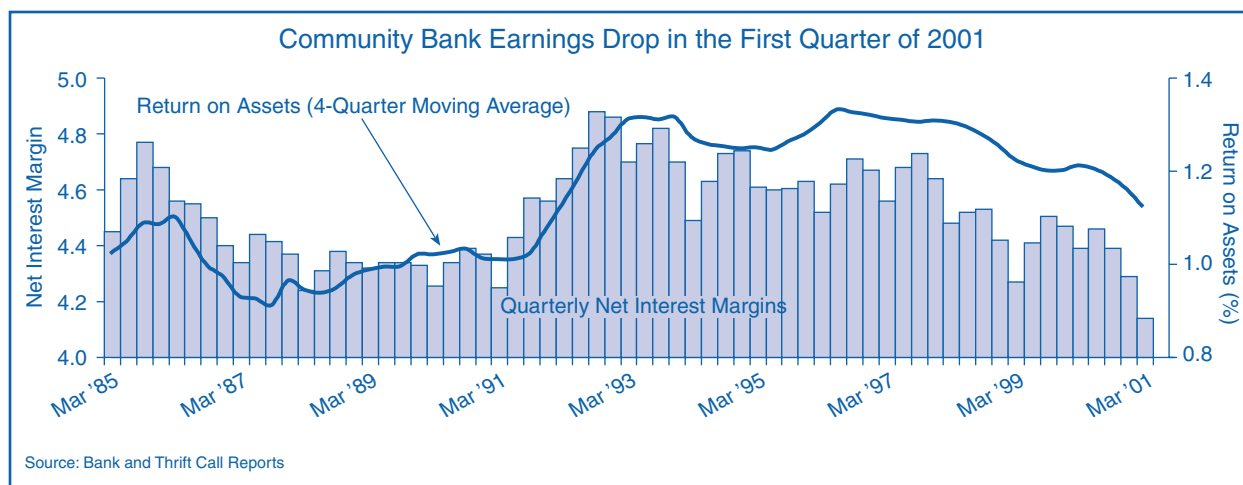
Changing Economic Conditions Affect Bank and Thrift Earnings and Asset Quality

National and regional economic growth has slowed considerably since last fall. Year-over-year job growth as of May 2001 was a meager 0.4 percent for both the nation and the Memphis Region, compared with employment growth rates of 2.7 and 1.9 percent, respectively, in the preceding 12-month period. Although banks and thrifts in the Region remain relatively well positioned to meet the challenges posed by this transition, changing economic conditions are affecting earnings and credit quality at insured financial institutions.

Community Bank Earnings Performance Stumbles in the First Quarter

Continuing a longer-term trend, but at an accelerating pace, the Region's community banks¹ reported a sharp drop in traditional earnings performance measures in first quarter 2001, as shown in Chart 1. Both return on assets (ROAs) and net interest margins (NIMs) declined to levels just above important thresholds, with the median ROA falling to 1.03 percent and the median NIM

CHART 1



¹ For the purposes of this analysis, community banks are defined as commercial banks with total assets of less than \$1 billion, excluding special-purpose institutions such as credit card and trust banks. Thrift institutions were excluded from this historical analysis of earnings performance because of the considerable NIM fluctuations reported by many thrifts in the 1980s.

falling to 4.09 percent.² NIMs, which represent a vital component of community bank earnings, reached the lowest levels reported in the 17 years for which such data have been collected. Several factors likely contributed to these historically low margins, including declining loan volumes, balance sheet optionality, and limited repricing of deposits.

Declining Loan Volumes: A decline in loan-to-asset (LTA) levels reported by banks and thrifts in the Region contributed to recent NIM compression.³ In the late 1990s, many community banks and thrifts sought to maintain earnings performance in the face of intense competition by accepting greater credit risk in the form of higher LTA ratios⁴ and increasing concentrations of traditionally higher-yielding and potentially higher-risk types of loans. Because of slow deposit growth, banks and thrifts frequently used higher-cost alternatives to fund these additional loans. With the slowdown in economic conditions beginning midyear 2000, a combination of waning loan demand and tightening underwriting standards contributed to a decline in loan volumes. This decline has predictably contributed to lower asset yields and, absent significant changes in funding composition, declining margins.

Optionality: The sharp decline in interest rates beginning in fourth quarter 2000 likely resulted in the exercise of embedded options in bank balance sheets. Many higher-rate loans were refinanced in recent periods, and call features on investment securities were exercised, influencing yields on both loans and securities.

“Sticky” Deposit Costs: Another factor contributing to the recent declines in NIMs is the limited ability to reprice deposit interest rates. During the most recent period of rising interest rates, from late 1999 through mid-2000, many banks and thrifts held deposit rates low or limited the increases in rates. As a result, some institutions have been unable to lower the rates paid on these deposits in 2001 as quickly as loans and investment returns have declined.

Earnings Outlook: NIMs should benefit significantly from the considerable steepening of the yield curve during the first half of 2001, but this improvement could be offset by declining levels of loans and increasing levels of nonearning assets should economic conditions deteriorate further. The low NIMs reported by banks and thrifts during the late 1980s and early 1990s shown in Chart 1 can be attributed in part to high levels of nonaccrual loans and repossessed assets. In contrast, the historically low NIMs in first quarter 2001 occurred with very low, albeit increasing, levels of nonearning assets. As a result, if nonearning assets continue to rise, NIMs are likely to fall further.

Declining ROAs have been affected by more than just low NIMs, however, as provision expenses have increased in recent quarters. Provisions continue to exceed net charge-offs, and allowance levels have risen slightly in recent quarters, as shown in Chart 2. The increase in allowances, however, has not kept pace with the growth in nonperforming loans,⁵ which may signal a need for provision expenses to continue at recent levels or to increase. Although many banks and thrifts have tightened underwriting standards in response to changing conditions, the possibility exists that additional deterioration in credit quality may occur in those loans originated during a period of stronger economic conditions and more lax underwriting standards. Many banks and thrifts in the Region already report higher loan delinquencies than one year ago,⁶ with the increase centered in consumer and construction lending.

Consumer Loan Portfolios Weaken as the Regional Economy Slows

Recent job losses, most notably in the manufacturing sector, increase the potential for deterioration in consumer loan portfolios, especially given the growth in consumer debt burdens in recent years. Readily available credit and the historic length of this economic expansion allowed consumers to assume increased debt. Consumers continued to borrow at high levels; household debt rose 12 percent in the first quarter of 2001 from levels of a year ago, one of the fastest rates reported during the past ten years.

² The median NIM of 4.09 in the first quarter of 2001 was down sharply from the 4.36 percent reported in the first quarter of 2000.

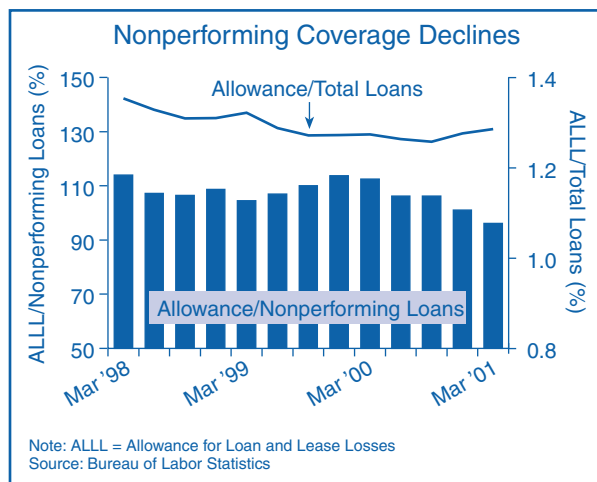
³ LTA ratios at the Region's community banks peaked at 67.1 percent on September 30, 2000, before falling to 65.8 percent on March 31, 2001.

⁴ This issue is discussed in detail in “Late Cycle Behavior: Earnings Pressures Lead to Increased Credit Risk,” *Memphis Regional Outlook*, fourth quarter 2000.

⁵ Nonperforming loans are those that have been placed on nonaccrual status or are 90 days or more past due.

⁶ Past-due and nonaccrual loans represented 2.88 percent of total loans among the Region's community banks as of March 31, 2001, compared with 2.47 percent in March 31, 2000. Much of the increase occurred in fourth quarter 2000, but delinquencies climbed modestly from fourth quarter 2000 to first quarter 2001.

CHART 2



More important, debt service payments as a share of disposable income rose above 14 percent in the first quarter of 2001,⁷ the highest level since 1987. More recently, consumers may have cut back on spending, adding only \$6.5 billion to their personal debt in May 2000, \$3 billion less than analysts' expectations.

The economic slowdown has made it increasingly difficult for some consumers to manage growing debt loads. Nationally, banks and thrifts reported an increase in consumer delinquencies and consumer loan losses from one year ago. Credit card delinquencies and mortgage foreclosures increased in the first quarter of 2001, while mortgage delinquencies leveled off from year-end 2000. However, the overall deterioration in quality of consumer credit has been modest.

Recent regulatory surveys reported mixed results regarding changes in consumer loan underwriting standards in response to slowing economic conditions. The Federal Reserve Board's *Senior Loan Officer Opinion Survey on Bank Lending Practices*, a survey of senior loan officers primarily at large financial institutions, indicates that consumer loan standards have been tightened in recent periods. The primary reason cited for this tightening was an expected decline in consumer credit quality. In contrast, the FDIC's *Report on Underwriting Practices from October 2000 through March 2001*, completed by regulatory staff following each FDIC examination and therefore weighted toward community banks, noted an increase in the frequency of risky underwriting practices for consumer lending. This

increase in risk associated with consumer lending contrasts with the overall strengthening of underwriting standards noted in the report.⁸ Specifically, the report detailed increases in the proportion of banks that made loans to consumers who lacked demonstrated repayment ability and of banks that extended consumer loans without adequate collateral protection.

Memphis Region banks may face greater challenges with consumer credit quality than insured institutions in other areas of the nation because

- consumer loan exposure at community banks (8.8 percent of total assets on March 31, 2001) is higher than in any other FDIC Region;
- employment has suffered more from weaknesses in manufacturing⁹ because the Memphis Region relies more heavily on that sector than does the nation as a whole; and
- debt burdens are greater for low-income consumers, who represent a larger share of the Region's population than is the case elsewhere in the nation (see the inset box "Debt Burdens Are Higher for Low-Income Families").

Consumer loan levels among the Region's community banks have steadily declined since 1997, as has been the case nationally, and continue to significantly affect overall asset quality. Even as consumer loan exposure declined in recent periods, consumer lending contributed a significant portion of total loan losses, as shown in Chart 3 (next page). In first quarter 2001, for example, consumer loan losses represented more than half of all loan losses for the Region's community banks. In addition, consumer loan delinquencies rose notably during the past year¹⁰ and are higher than delinquencies reported for other loan types.

Absent a quick economic recovery, consumer credit quality in the Region may deteriorate further. Signifi-

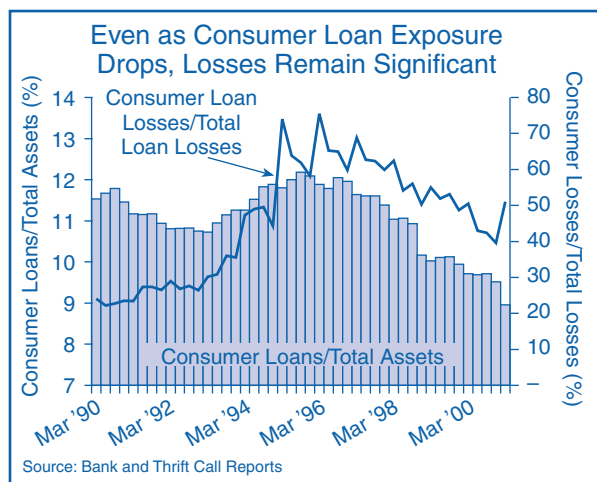
⁷ Federal Reserve Bank of St. Louis. *National Economic Trends*. June 2001.

⁸ The only other loan type identified by FDIC examiners as exhibiting an increase in risky practices during the period was construction lending, which is discussed later in this article.

⁹ The Region's manufacturing sector reported net job losses totaling 52,000 from June 2000 through April 2001, or 3.5 percent of total manufacturing jobs. This contraction is considerably greater than the 39,000 manufacturing jobs, or 2.6 percent of total manufacturing employment, lost in the Region during the 1990–1991 national recession.

¹⁰ Past-due and nonaccrual consumer loans rose from 2.69 percent of consumer loans on March 31, 2000, to 3.47 percent of consumer loans on March 31, 2001.

CHART 3



cant layoff announcements continued into the second quarter of 2001, and many previously announced layoffs have only recently occurred, suggesting that the number of unemployed is likely to rise. As unemployment benefits, severance packages, and savings are exhausted, consumer loan delinquencies may climb. Two factors, however, could aid consumers' repayment abilities: declining interest rates and tax rebates. Lower interest rates make it easier for consumers to service debt because of lower monthly payments on consumer loans and an enhanced ability to refinance consumer debt into home mortgages.¹¹ Tax rebates in the late

¹¹ During the 1998 mortgage-refinancing boom, many consumers took advantage of low mortgage rates to refinance existing mortgages and cash out equity in their homes to pay down high-cost consumer debt. With an overall decline in interest rates since midyear 2000, some consumers may find it advantageous to once again lower their consumer debt by refinancing.

Debt Burdens Are Higher for Low-Income Families

Consumer debt burdens are rising and are particularly high among families at the lower end of the income scale. According to the Federal Reserve Board's **1998 Survey of Consumer Finances**, the percentage of families with high debt service (payments representing 40 percent or more of income) rose between 1995 and 1998 from 10.5 percent to 12.7 percent. As shown in Table 1, families with low income levels tend to have the highest level of debt service payments.

Family income levels in the Memphis Region are particularly low. Compared with 29.0 percent nationally,

38.4 percent of the Region's families earn less than \$25,000 per year. Among the Region's states, Tennessee reports that 35 percent of its families earn less than \$25,000, the lowest percentage in the region. **Arkansas, Louisiana, and Kentucky** all reported ratios between 39.2 and 39.5 percent, while **Mississippi** reported a ratio of more than 42 percent.

The larger number of low-income families in the Region suggests that individual borrowers are more likely to have higher debt than is the case nationally. Lower-income families also may be more affected by recent and potential layoffs, making it difficult for them to meet debt obligations. In turn, consumer credit quality at institutions serving these families may ultimately be adversely affected.

TABLE 1

THE MEMPHIS REGION'S INCOME LEVELS ARE LOWER THAN THE NATION'S			
ANNUAL INCOME RANGE	PERCENT OF POPULATION		PERCENT OF HIGHLY INDEBTED FAMILIES*
	NATION	REGION	
LESS THAN \$10,000	9.3%	14.0%	32.0%
\$10,000 - \$24,999	19.7%	24.4%	19.9%
\$25,000 - \$49,999	28.4%	29.1%	13.8%
\$50,000 - \$99,999	30.3%	25.0%	5.7%
\$100,000 OR MORE	12.3%	7.5%	2.1%

*FAMILIES WHOSE DEBT SERVICE PAYMENTS ARE ABOVE 40% OF INCOME.

SOURCE: CLARITAS REPORTS; BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

TABLE 2

TOP MARKETS WITH COMMUNITY BANK C&D LOAN EXPOSURE INCLUDE THREE MEMPHIS REGION METROPOLITAN AREAS		
METROPOLITAN AREA	SHARE (%) OF BANKS IN MARKET REPORTING C&D CONCENTRATIONS	AGGREGATE C&D LOANS/ TIER 1 CAPITAL
LAS VEGAS, NV	73.7	117.1
ATLANTA, GA	71.3	165.3
RIVERSIDE, CA	61.1	142.1
PORTLAND, OR	57.1	143.3
GRAND RAPIDS, MI	55.0	99.5
MEMPHIS, TN	53.9	127.0
PHOENIX, AZ	51.9	141.0
DENVER, CO	50.0	112.1
FAYETTEVILLE, AR	50.0	94.3
LEXINGTON, KY	50.0	85.4

NOTES: ONLY METROPOLITAN MARKETS WITH 15 OR MORE REPORTING INSTITUTIONS WERE CONSIDERED.
DEFINITIONS: COMMUNITY BANKS ARE BANKS AND THRIFTS WITH LESS THAN \$1 BILLION IN TOTAL ASSETS, EXCLUDING SPECIALTY INSTITUTIONS SUCH AS CREDIT CARD OR TRUST INSTITUTIONS. BANKS WITH C&D CONCENTRATIONS ARE THOSE REPORTING CONSTRUCTION AND DEVELOPMENT LOANS EQUIVALENT TO 100 PERCENT OR MORE OF TIER 1 LEVERAGE CAPITAL.
C&D = CONSTRUCTION AND DEVELOPMENT
SOURCE: BANK AND THRIFT CALL REPORTS

summer and fall also may contribute to consumer debt reduction. The extent to which these factors allow consumers to reduce their debt burdens or fuel additional spending remains questionable.

Rural banks in the Region may be more at risk for deterioration in consumer credit quality because of higher exposure and weaker economic conditions. As of March 31, 2001, consumer loans constituted 9.6 percent of assets at rural banks compared with 8.0 percent of assets at urban lenders. Recent layoffs also are concentrated in rural areas as the manufacturing sector represents a much larger segment of rural economies. In fact, rural counties, weighed down by manufacturing layoffs, reported a contraction in employment from one year ago, while employment in urban counties grew 0.6 percent. Not surprisingly, past-due consumer loan ratios at rural community banks were considerably higher than at their urban counterparts in first quarter 2001.¹²

¹² Past-due and nonaccrual consumer loans represented 4.03 percent of consumer loans among the Region's rural community banks as of March 31, 2001, up 87 basis points from the previous year. By comparison, past-due and nonaccrual consumer loans represented 2.50 percent of consumer loans among the Region's urban banks as of March 31, 2001, up 56 basis points from the previous year.

Construction Lending Concerns Emerge in Some Metropolitan Markets

Service sector employment gains have helped maintain positive growth in the Region's metropolitan areas. However, a slowing rate of growth in some markets may contribute to weaker demand for real estate and affect construction and development (C&D) loan portfolios. Construction lending exposure is high at many insured financial institutions, with much of this exposure believed to be concentrated in residential construction. Asset quality measures suggest some deterioration in C&D loan portfolios. The aggregate C&D past-due loan ratio for the Region's community banks and thrifts climbed steadily from one year ago, with the largest jump occurring in first quarter 2001.¹³

Table 2 lists metropolitan markets nationally in which at least half the community banks headquartered in those markets¹⁴ reported C&D loan concentrations

¹³ C&D past-due loans reported at Memphis Region community banks and thrifts increased from 2.06 percent of total C&D loans as of March 31, 2000, to 2.55 percent as of December 31, 2000. This ratio climbed to 3.00 percent as of March 31, 2001.

¹⁴ This analysis is limited to metropolitan markets with 15 or more community banks. Community banks for purposes of this analysis are those banks and thrifts that report less than \$1 billion in total assets and that are not special-purpose institutions such as credit card lenders or trust banks.

Economic Briefs: Conditions Vary among Markets with High C&D Exposure

Fayetteville and **Lexington** reported the lowest unemployment rates among metropolitan areas in the Region at 1.9 percent and 2.5 percent, respectively, as of May 2001 and continue to post solid employment growth despite a heavy reliance on the manufacturing sector.¹⁶ A large segment of Fayetteville's manufacturing is food-based and therefore somewhat insulated from the current contraction in the manufacturing sector, while Lexington's automobile production has held up much better than in other areas of the nation. Although the economies of both markets appear strong, high concentrations in manufacturing employment in both cities increase their vulnerability in the event of continuing national economic weakness.

Little Rock reported flat employment growth from May 2000 through May 2001 as payrolls declined in several key industry sectors. The metropolitan area's unemployment rate remains relatively low as declining in-migration has constrained labor force expansion. A

¹⁶ Year-over-year employment growth as of May 2001 for Fayetteville and Lexington was 2.4 percent and 1.5 percent, respectively. Manufacturing makes up 23.1 percent of Fayetteville's employment and 17 percent of Lexington's, compared with 14 percent nationally. Source: Bureau of Labor Statistics.

high level of government employment provides some cushion against further cyclical slowing.

The **Memphis** economy, while still growing, slowed over the preceding year. As the gateway between Arkansas, Mississippi, and **Tennessee**, Memphis has been affected by weakening economic conditions in each of these states. The city is vulnerable to further slowing because of a heavy reliance on the transportation and distribution sectors.¹⁷

Nashville's economy also slowed, with a 1.0 percent year-over-year employment gain as of May 2001. Service sector job growth in Nashville remains strong, led in part by a modest recovery in the city's beleaguered health care industry. Although automobile sales have remained robust, further slowing in the national economy could affect the area's manufacturing sector.¹⁸

¹⁷ As an example of the potential vulnerability of the transportation and distribution sector, Federal Express, the largest employer in Memphis with approximately 30,000 employees, has announced disappointing earnings and numerous profit warnings in recent quarters, citing sharply reduced demand for express shipping services because of continuing weak economic conditions, both nationally and globally.

¹⁸ Nashville is somewhat dependent on the automobile sector, with Saturn Corporation and Nissan Motors representing the third and fourth largest employers, respectively, in the metropolitan area. Although Nissan sales have been strong of late, Saturn sales have been weak, which prompted a considerable drop in production early in 2001 in an effort to reduce growing inventory levels. Another large automotive parts producer in the area, Bridgestone/Firestone, Inc., continues to struggle with recalls.

equivalent to 100 percent or more of Tier 1 Leverage capital as of March 31, 2001. As shown in the table, the **Memphis, Fayetteville-Springdale**, and **Lexington** metropolitan markets ranked among the top ten markets nationally. Two other Memphis Region metropolitan areas ranked in the top 20: **Little Rock** at 17th and **Nashville** at 19th.

Of these five markets, Memphis appears most vulnerable because of substantially higher exposure levels, a preponderance of speculative rather than pre-sold development, and a current oversupply of homes. Memphis area banks and thrifts reported a sharp increase in delinquent construction loans with aggregate C&D past-due loans climbing from 1.06 percent on March 31, 2000, to 4.20 percent as of March 31, 2001.

In the late 1990s, new home construction in Memphis greatly exceeded new home sales, leading to oversupply. Only in 2000 did this begin to reverse as housing starts declined. Even as residential construction moderated, many banks and thrifts in Memphis continued to aggressively add to construction loan portfolios. By year-end 2000, aggregate C&D loan exposure among Memphis area community banks and thrifts represented 12.3 percent of total assets, more than double the 5.5 percent reported among community banks headquartered in metropolitan areas nationally.¹⁵ Memphis area banks and thrifts have faced intense competitive pres-

¹⁵ The level of aggregate exposure at Memphis area community banks ranks third among metropolitan areas with 15 or more community banks, behind only Atlanta and Portland.

tures in recent years, and many institutions may have emphasized construction lending because of the higher fees and yields available from these loans compared with other loan types.

Weaknesses in the Memphis residential market are evidenced by the recent bankruptcy of one of the area's largest builders. Anecdotal evidence suggests that the financial woes of this large builder were not isolated, as many area builders and developers struggle with slowing sales, declining profitability and cash flows, and substantial inventories of unsold homes. Weaknesses to date have been concentrated in higher-priced speculative homes and in certain geographic areas. Unlike many other markets nationally, a substantial portion of residential development in Memphis has involved speculative construction.

The other four regional markets with high C&D exposure also reported slowing residential development in recent periods, which should help mitigate potential supply/demand imbalances. But high construction loan exposure makes banks and thrifts in these markets more vulnerable to changing economic and real estate market conditions. Local economic conditions in these markets currently present a mixed picture (see inset "Economic Briefs: Conditions Vary among Markets with High C&D Exposure").

Risk Managers Face Challenges with the Economy in Transition

Strong economic conditions throughout most of the 1990s provided lenders with greater comfort and flexibility in the application of underwriting standards without incurring substantial incremental risk. However, the current economic slowdown raises the level of incremental risk associated with each credit decision. Regardless of whether the recent slowing is merely a temporary inventory adjustment or part of a more pronounced cycle, front-line risk managers must adjust to changing economic fundamentals.

The results of recent loan underwriting surveys and loan growth trends suggest that some risk managers are concerned with potential deterioration in credit quality and have taken steps to minimize potential losses. But banks and thrifts also face an intensely competitive environment that is compressing margins and returns. Managers must respond to potential pressure from boards of directors and stockholders with respect to asset and revenue growth objectives, profitability goals, and market share expectations while continuing to operate their institutions in a safe and sound manner. The task of balancing risk-reward trade-offs has become more difficult in a less forgiving economic climate.

By the Memphis Region Staff

Slowing Economy Reduces Demand for U.S. Office Space

- **Demand for U.S. office space contracted during the first half of this year as the amount of newly vacated space exceeded the amount of newly occupied space for the first time since at least 1981.**
- **The U.S. office vacancy rate jumped 250 basis points in the first half of 2001, from 8.3 percent to 10.8 percent.**
- **With construction levels remaining high and demand still weak, the vacancy rate could rise further by year-end.**

Overview

Commercial real estate (CRE) markets traditionally have been—and remain—highly cyclical. During the 1990s, most U.S. office markets experienced a strong upswing. However, declining office employment growth along with other recent signs point to a possible downturn. As reported by *Torto Wheaton Research* (TWR), the U.S. office vacancy rate, which stood at a 19-year low of 8.3 percent at the end of 2000, jumped in only six months to 10.8 percent, the largest six-month increase in the 20 years TWR has tracked these data. Office vacancy increases range from modest levels in some markets to high levels in markets where supply and demand imbalances are more pronounced.

An uptick in construction activity combined with a substantial drop in demand for office space has led to a slackening of office market conditions. In light of the ongoing uncertainty as to the near-term direction of the U.S. economy, these trends make the current situation difficult for office market participants to read.

This article reviews recent developments in U.S. office markets and describes demand-side and supply-side trends that have contributed to the recent weakness.¹ It notes the role played by the changing fortunes of

high-tech firms in a number of metropolitan areas and how this situation has increased the volume of space available for sublease. Finally, the article focuses on the local construction loan exposures of insured banks and thrifts that have the task of managing their risks under changing market conditions.

Vacancy Rates Have Risen Quickly from Cyclical Lows

At year-end 2000, the U.S. office vacancy rate stood at 8.3 percent—a 19-year low. Many individual metro areas posted even lower vacancy rates. For example, at year-end 2000, vacancies were 4.4 percent of available space in Seattle, 1.3 percent in San Jose, and 3.0 percent in Oakland. Beginning with first quarter 2001, as a result of a slowing economy and the fallout from the so-called “tech-wreck,” the U.S. vacancy rate rose by 120 basis points to 9.5 percent—the highest absolute quarterly increase since these data were first published in 1981. Another record increase of 130 basis points occurred during the second quarter, bringing the vacancy rate to 10.8 percent. To put these increases in perspective, consider that the national office vacancy rate has increased more than 50 basis points in any given quarter only twice.² Nonetheless, the current vacancy rate of 10.8 percent remains low by historical standards, as the average rate for the past 20 years has been 13.9 percent.

Most of the nation’s large metro areas saw increases in office vacancies during the first half of 2001. Forty-eight of the 53 major metropolitan areas tracked by TWR recorded a higher vacancy rate in June 2001 than at year-end 2000. Thirty-eight markets experienced increases of at least 100 basis points, and four markets saw vacancy rates jump by more than 600 basis points. As shown in Table 1 (next page), most of the markets experiencing the largest jump in vacancy rates also are home to concentrations of high-tech employment.³ As

¹ For further discussion of demand and supply trends, see Sally Gordon, “CMBS: Red – Yellow – Green™ Update, Second Quarter 2001 Quarterly Assessment of U.S. Property Markets,” *Moody’s Investors Service*, July 6, 2001.

² TWR notes increases of 60 basis points in the second quarter of 1989 and in the first quarter of 1999.

³ Seven of the ten markets with the highest first-half 2001 vacancy rate increases are also among the top ten cities having the greatest levels of high-tech employment.

TABLE 1

IN MANY MARKETS, OFFICE VACANCY RATES REFLECT CONCENTRATIONS OF HIGH-TECH EMPLOYMENT				
METRO AREA	VACANCY RATE AS OF 6/30/01 (%)	VACANCY RATE AS OF 12/31/00 (%)	INCREASE IN VACANCY RATE (BASIS POINTS)	HIGH-TECH AS % OF TOTAL MARKET EMPLOYMENT
AUSTIN	11.8	5.0	680	10.1
SAN JOSE	8.1	1.3	680	27.4
OAKLAND	9.3	3.0	630	6.5
SAN FRANCISCO	10.3	4.1	620	8.3
SEATTLE	9.4	4.4	500	6.6
KANSAS CITY	15.9	11.0	490	2.7
BOSTON	8.7	3.9	480	8.2
PHOENIX	16.9	12.5	440	4.7
WILMINGTON, DE	10.4	6.2	420	3.8
WASHINGTON, DC	7.8	3.9	390	7.8
NATION	10.8	8.3	250	4.8

SOURCES: TORTO WHEATON RESEARCH, ECONOMY.COM, INC.

high-tech markets spurred higher demand for office space in the recent past, these markets are now giving back greater quantities of previously occupied office space. Table 2 (see page 18) lists office vacancy rates and changes along with lending concentrations, construction activity levels, and high-tech employment percentages for 53 major metropolitan areas and for the nation.

Unlike the last cycle, during which office vacancies shot up primarily in overbuilt downtown areas, recent increases are occurring more sharply in suburban than downtown sections of metropolitan areas. As of June 30, 2001, the average downtown office vacancy rate was 8.5 percent, and the average for suburban markets was 12.1 percent. Increases in office availability are dispersed among Class A office properties as well as Class B/C properties, yet vacancy rates do show disparities across many submarkets. For example, the South of Market area in San Francisco reports significantly higher office vacancy rates than the Financial District.⁴ Similarly, in the Washington, DC, metropolitan area, the technology-intensive northern Virginia office market has experienced higher office vacancy increases than downtown Washington, DC, or suburban Maryland.

⁴ Louis, Arthur M. July 24, 2001. "Empty Offices, Economic Downturn, Overconstruction Leave Commercial Landlords with More Space on their Hands." *San Francisco Chronicle*.

Office Demand Drops

Net absorption, the primary indicator of demand for office space, was negative during first quarter 2001 for the first time since TWR began reporting the series.⁵ (Negative absorption occurs when space returned to the market by existing tenants exceeds the space occupied by new tenants.) This negative performance was repeated in the second quarter. The decline in the volume of competitively leased space totaled 30 million square feet during the first half of 2001. (See Chart 1.)

The bulk of negative absorption in the first half of 2001 is due to the return of office space to the market through subleasing.⁶ TWR reports that there were 43 million square feet of space "give-backs" through subleasing in the first half of 2001, and after offsetting absorption of 13 million square feet, negative absorption was 30 million square feet.

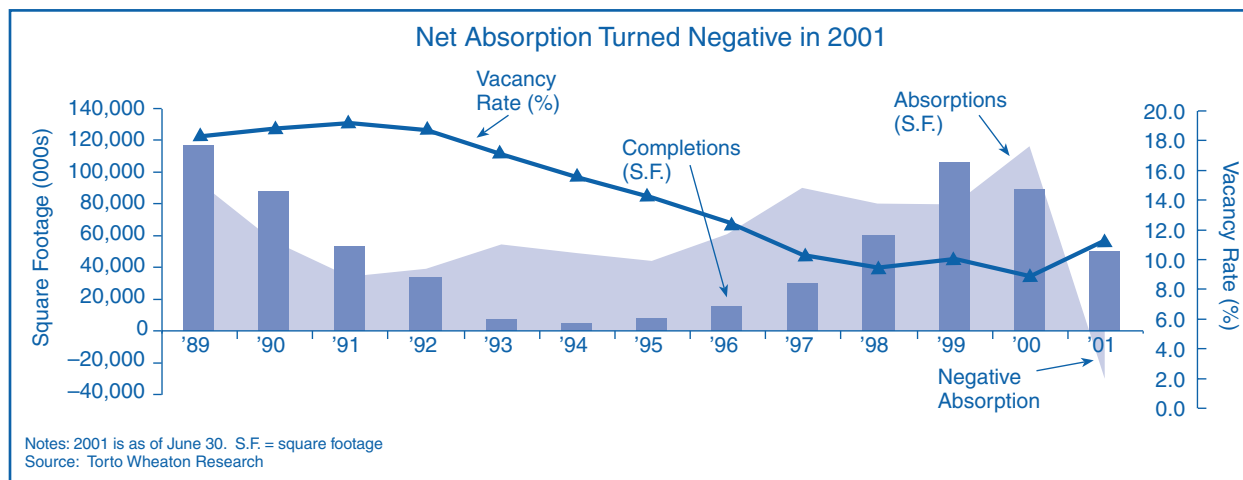
Office employment growth, the source of new office space demand, tends to be driven by the finance and services sectors.⁷ Year-over-year job growth in the finance,

⁵ Net absorption is the net change in total competitively leased space per period, as measured in square feet.

⁶ In some metropolitan areas, over half the total office space available for rent (vacant space) is sublease space.

⁷ TWR constructs its office employment index based on trends in the FIRE sector plus selected categories of the services sector. See *TWR Office Outlook*, Spring 2001, Vol. II, p. A.1.

CHART 1



insurance, and real estate (FIRE) and services sectors combined was more than 3 percent in every month from January 1993 through June 2000. Since the middle of 2000, job growth in these sectors has fallen steadily to a year-over-year rate of less than 1.5 percent in June 2001. A spring 2001 survey conducted by **Salomon Smith Barney** indicated that tenants estimated their growth in office space demand to be only 0.6 percent over the following 12-month period.⁸ Also contributing to reductions in demand are increases in worker layoffs. Announced layoffs during the first seven months of 2001 totaled over 983,000 individuals, more than triple the number of announced layoffs during the same period last year.⁹

The slowdown in the demand for office space contrasts sharply with the situation last year, when absorption rates and office employment growth were robust in most markets, and leases were executed quickly for newly constructed properties. As shown in Chart 2, absorption of office space in 2000 actually outstripped the trend in office employment by a considerable margin. Why? With relatively easy access to initial public offering and venture capital funding, many startup firms anticipated rapid growth and leased office properties accordingly. In fact, venture capital funding facilitated historically higher rates of office space absorption by high-tech and other startups. In active bidding wars, new high-tech firms increased their office space holdings. A phenomenon of *space hoarding* developed in which some high-tech companies leased large quantities of office space in anticipation of future expansion.

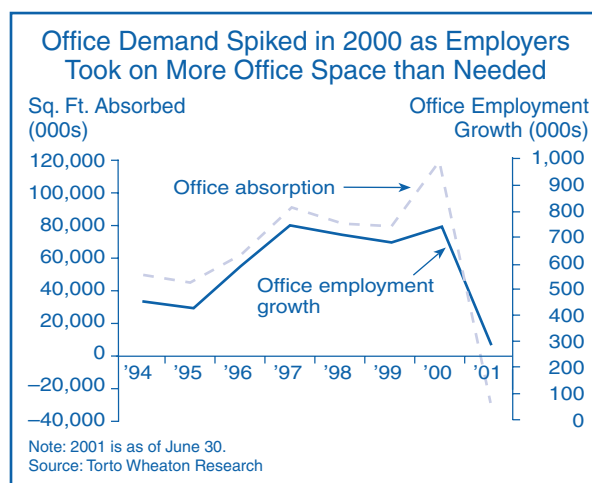
⁸ Boston, Gary, Ross Nussbaum, and Jonathan Litt. May 16, 2001. "Real Estate Demand Survey." *Equity Research: United States, Real Estate Investment Trusts*. Salomon Smith Barney.

⁹ Data provided to Haver Analytics by Challenger, Gray & Christmas.

More recently, because of a slowing economy, curtailed funding, and failures to achieve sales expectations, many high-tech and dot-com firms have closed or scaled back operations significantly. At the same time, traditional firms have reconsidered plans to expand, adopting a "wait and see" attitude. Consequently, as demand for space declines, large blocks of office space are returning to markets for sublease.

Space available for sublease is similar to landlord-offered space available for rent—space under both categories should count toward a market's available rental space. However, in the case of subleasing, tenants, rather than landlords, offer properties for rent. Tenants may attempt to sublease the property themselves or use a broker; however, in general, only space handled by a broker is included in the tally of a market's available rental space. Consequently, current office vacancy increases could be higher than reported.

CHART 2



Meanwhile, Construction Continues

An uptick in office construction activity that began in many metro areas during the late 1990s has been a key element contributing to recent increases in office vacancies. According to the *Bureau of the Census*, U.S. expenditures on office construction totaled \$47.5 billion in 2000, continuing a seven-year cycle of expansion. Adjusted for inflation, this amount represents about 78 percent of the peak level of office construction expenditures that occurred in 1985. Recently, the pace of construction has slowed slightly, falling to an annualized rate of \$44.3 billion in May 2001.

Reflecting these large dollar outlays on office construction, TWR projected in December 2000 that 111.3 million square feet of new office space (or 3.6 percent of existing stock) would be completed during 2001. This newly completed space will come on the market following a period of rising construction activity from 1998 through 2000, during which the volume of completed office space averaged 84.9 million square feet per year. As shown in Chart 3, however, current office construction activity as a percentage of existing stock falls well below that of the 1980s.

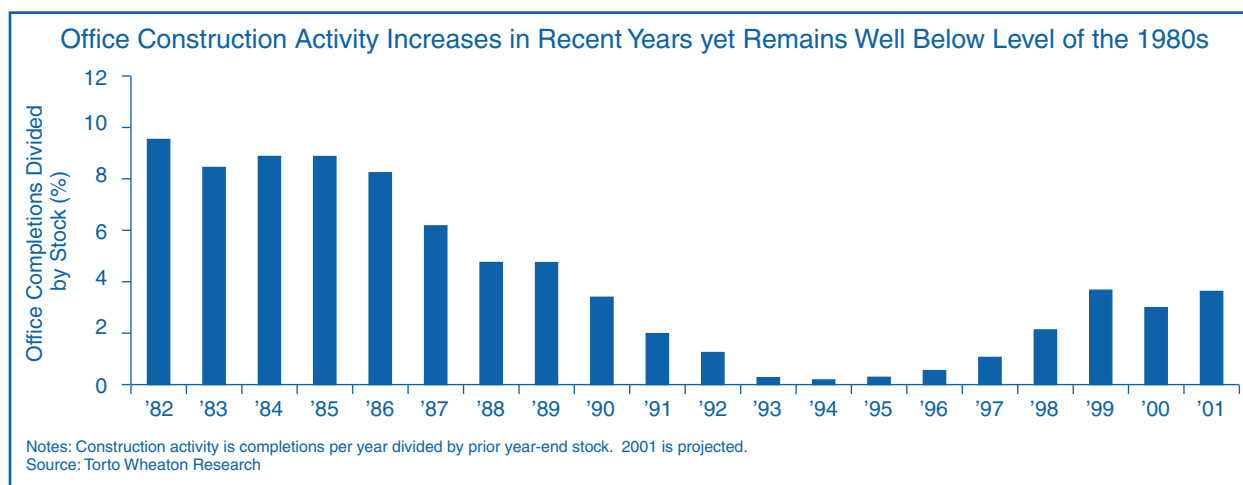
Many metropolitan areas currently experiencing high levels of construction activity also are seeing the largest increases in office vacancies. For example, cities that are positioned toward the upper right quadrant of Chart 4 are characterized by higher vacancy rate increases and more new office space construction. The ten cities with the highest first-half 2001 vacancy rate increases had total square footage of under-construction office space at 6.5 percent of existing stock as of year-end 2000.¹⁰ By comparison, total office space under construction nationally was 4.5 percent of existing stock.¹¹

Even as most projects move toward completion, some developers are reconsidering office construction plans. Builders have stopped construction of significant projects midstream in the Austin, Dallas, Seattle, and northern Virginia markets in response to retrenchment by major tenants and competition from subleased space.

Softening Extends to Other Commercial Real Estate

Other major commercial real estate markets are also feeling the effects of a slowing economy and, with the exception of the retail sector, are experiencing increasing vacancy rates.

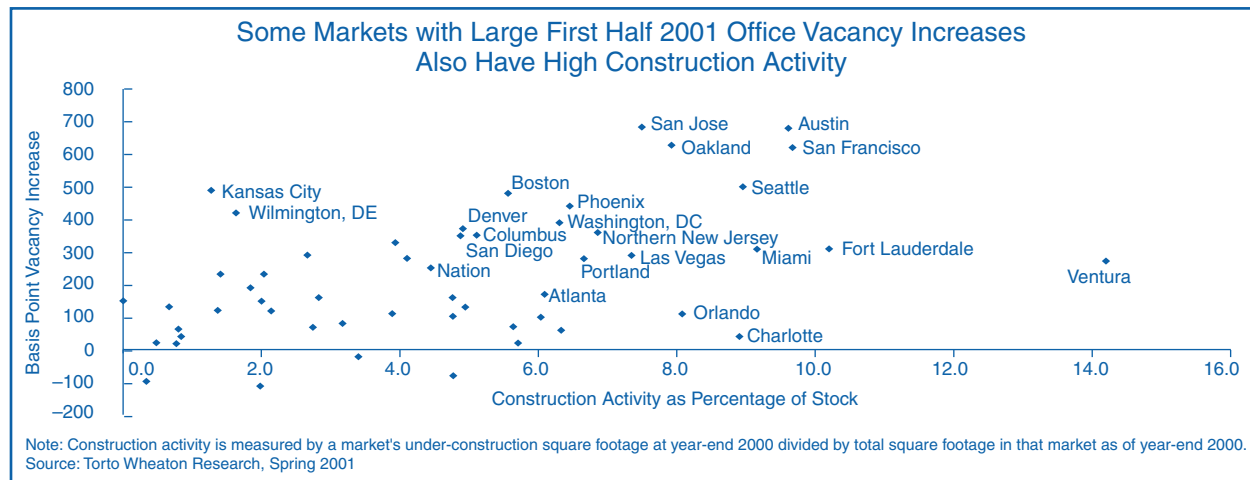
CHART 3



¹⁰ One measure of a metropolitan area's exposure to overbuilding and rising vacancy rates is the degree of construction activity. This measure is found by dividing a metropolitan area's completions square footage or the under-construction square footage by the total stock of office property.

¹¹ The national 4.5 percent level for office properties *under construction* at December 2000 is higher than the 3.6 percent level for projected *completions* in 2001 because not all properties being built in 2001 will be completed during the year.

CHART 4



Industrial vacancy rates had fared well in recent years. As of year-end 2000, the national vacancy rate of 6.7 percent was the lowest since 1984. Now, however, a 150-basis-point increase has occurred, with industrial vacancies increasing to 8.2 percent in the first half of 2001.¹²

As the economy and the nation's high-tech and manufacturing sectors continue to slow, demand for industrial space for research and development and storage and distribution is declining. Industrial property subleasing is on the rise, and negative absorption occurred in the first half of 2001. At the same time, completions of industrial space during 2001 are estimated to exceed 220 million square feet, the highest level since 1988. Landlords are offering concessions, such as lease terms of one year compared with five to ten years, in an attempt to attract new tenants.

Industrial properties are somewhat less exposed to risks from overbuilding than office properties because of shorter construction periods and the ability to respond quickly to any change in demand. An exception is the *telecommunication hotel*,¹³ a new entry into this market. This property type is characterized by a longer construction cycle and the fact that it typically has a "single use" design. In recent months, construction of these structures began in many high-tech markets to provide enhanced levels of data service. With declining demand, some telecom hotels stand vacant.

¹² Torto Wheaton Research.

¹³ Telecom hotels are large, high-energy-consuming warehouses that house machinery, servers, routers, and switches that are the physical underpinning of the electronic commerce conducted on the Internet. They are hotels in the sense that they house equipment belonging to many different telecommunication companies. John Holusha, "Home for Machinery of the Internet," *The New York Times*, August 16, 2000.

The demand for **hotel** rooms is adversely affected by a slowing economy. Businesses have cut travel budgets and consumers have scaled back leisure plans, contributing to a decline in occupancy levels and revenue per available hotel room in most markets throughout 2001. Currently, upscale and luxury hotels are suffering more than limited service hotels. According to *Smith Travel Research*, limited service hotels, particularly budget hotels, represent the only lodging sector with higher occupancy levels through the first four months of 2001 when compared to the same four month period in 2000.

The supply of new hotel properties is lower than in the past, as financing for new hotel construction for the most part has been curtailed in recent years. However, limited service hotels are reported to be overbuilt in a number of markets in the Southeast and Southwest.¹⁴ Annualized expenditures for new construction of all hotel types were \$12.1 billion as of May 2001, falling to the lowest level since 1996.¹⁵

The **multifamily** sector has experienced robust construction and equally strong absorption in recent years as new household formation, the driver for apartment demand, continues to increase. Annualized construction expenditures of \$25.5 billion as of May 2001 were at the highest level since 1989.¹⁶ Despite the relative equilibrium between supply and demand for apartments in most markets, vacancy increases and rent declines are occurring in some locations. This decline has been most acute

¹⁴ Kozel, Peter P. June 18, 2001. "U.S. Commercial Property Markets in a Slowing Economy: Implications for CMBS Credit Performance." *Standard and Poor's Structured Finance*.

¹⁵ Data provided to Haver Analytics by U.S. Bureau of the Census.

¹⁶ Ibid.

in the more concentrated high-tech markets, such as San Francisco, where reported average rental rates dropped 8.1 percent between the end of March and the end of May 2001.¹⁷

Despite a slowing economy, the **retail** sector has performed reasonably well, as consumers maintain relatively high spending levels. Many of the store closings in 2000 and 2001 have been absorbed by new tenants as landlords have acted quickly to avoid letting vacant space linger. Meanwhile, robust construction has continued, with total expenditures in 2000 of \$52.6 billion and an annualized level of \$52.2 billion as of May 2001. Each of these two years' expenditure levels exceeds all previous years' retail construction amounts since data were first gathered in 1964.¹⁸

Taking note of the robust level of retail construction activity, a recent **Moody's** article finds that the nation's mall retail and "power center"¹⁹ space grew by 3.3 percent in 2000, while population growth expanded by only 1.2 percent. The article raises concerns for potential excess supply of retail space resulting from a construction rate that is almost triple the population growth rate.²⁰ A negative consequence of the high rate of retail construction is found in a recent **Standard and Poor's** study. This article points out that most of the retail mortgages (held in commercial mortgage-backed pools of assets) that defaulted during 2000 did so because of competition from new retail establishments.²¹

Implications for Insured Institutions

Office vacancy rates during the first half of 2001 increased at an unprecedented rate. What does this mean for insured institutions? On the one hand, at mid-2001 vacancy rates remained below their 20-year average. Yet the speed of the increase and the number of

metropolitan areas that have experienced softening make this a trend that deserves the close attention of insured institutions, especially those with significant concentrations in commercial real estate and construction lending.

Financial indicators of real estate credit quality in banking remain favorable, with losses and delinquencies trending up modestly from minimal levels. Noncurrent construction and development (C&D) loans as of March 31, 2001, remain at a relatively low .92 percent of all outstanding C&D loans. (Noncurrent C&D loans as a percentage of all C&D loans averaged .93 percent for the past five year-ends.) Similarly, noncurrent CRE loans²² as of March 31, 2001, were .82 percent of all CRE loans, a level consistent with the average for this ratio of 1.08 percent for the past five year-ends. Charge-off ratios at March 31, 2001, for both C&D and CRE loans were each at .02 percent and remain below the averages of .05 percent for each for the past five year-ends. These favorable numbers are the legacy of a strong economic expansion, whereas current economic events suggest the potential for future deterioration in credit quality.

The outlook for commercial real estate credit quality depends on the depth and duration of the current economic slowdown and on the risk management practices of each institution. In this regard, as signs of increasing risk materialize in conjunction with a declining economy, lenders appear to be managing risks prudently and avoiding speculative lending.²³ Anecdotal information suggests that borrowers are pressed to obtain higher prelease commitment levels in order to gain loan approvals. In addition, lenders are requiring more up-front equity.^{24,25}

The importance of risk management practices is magnified by the heightened lending concentrations currently prevailing at some banks. Institutions with elevated concentrations in CRE and C&D lending have been more likely to experience significant problems during times of economic stress (for further details,

¹⁷ Associated Press, News in Brief from the San Francisco Bay Area, June 13, 2001.

¹⁸ Data provided to Haver Analytics by U.S. Bureau of the Census.

¹⁹ According to the Urban Land Institute, a power center is a community shopping center in which at least 75 to 90 percent of the selling space is devoted to multiple off-price anchors and a discount department store or warehouse club. It is the "power" of its anchors that gives the center its name.

²⁰ Sally Gordon, op. cit.

²¹ Kozel, Peter P. April 20, 2001. "Outlook for Property Markets in a Slower-Growing Economy and the Implications for CMBS Credit Performance." *Standard & Poor's Structured Finance*.

²² CRE loans are nonfarm, nonresidential loans secured by real estate.

²³ Speculative construction lending is defined as a loan not accompanied by a meaningful presale, prelease, or take-out commitment.

²⁴ "Capital Is Still Plentiful for Right Projects." *Midwest Real Estate News*. July 2001. Vol. 17, No. 7.

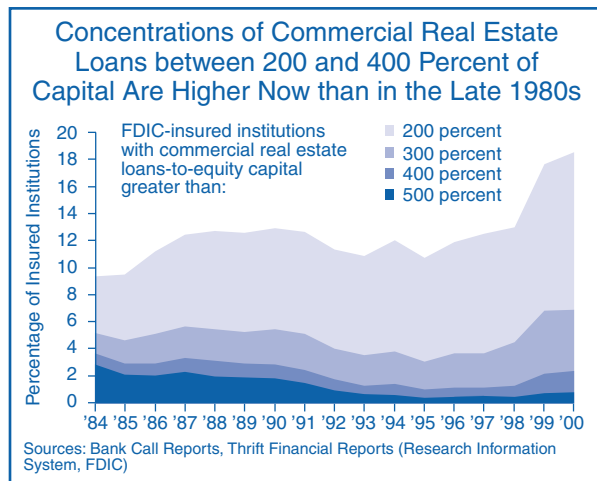
²⁵ Further information on bank underwriting practices can be found in Federal Deposit Insurance Corporation, Division of Research and Statistics, *Report on Underwriting Practices*, <http://www.fdic.gov/bank/analytical/report/index.html>.

see *History of the Eighties*²⁶). As shown in Chart 5, the percentage of insured institutions with commercial real estate loan concentrations between 200 and 400 percent of capital is higher now than it was in the late 1980s. However, there are relatively fewer institutions at the highest concentration level, in excess of 500 percent of capital. In fact, fewer than 1 percent of insured institutions are at this level. A similar story holds true for construction loans, as the increasing concentrations are in the range of 100 to 300 percent of capital (see Chart 6).

There are a number of issues for construction lenders and commercial real estate lenders to consider going forward. Because uncovered loans (C&D loans made without assurances of a firm take-out commitment) tend to be higher-risk, an important part of managing the risk in construction lending has traditionally been the lender's ability to obtain a take-out commitment.

Sources of take-outs for C&D loans include other insured institutions, pension funds, foreign investors, and life insurance companies, along with public-market real estate investment trusts (REITs) and conventional mortgage-backed securities (CMBs). Anecdotal reports indicate that shifts in market sentiment in recent months have resulted in lowered investments in REITs and consequently less available capital for REITs to purchase real estate.²⁷ Insured institutions

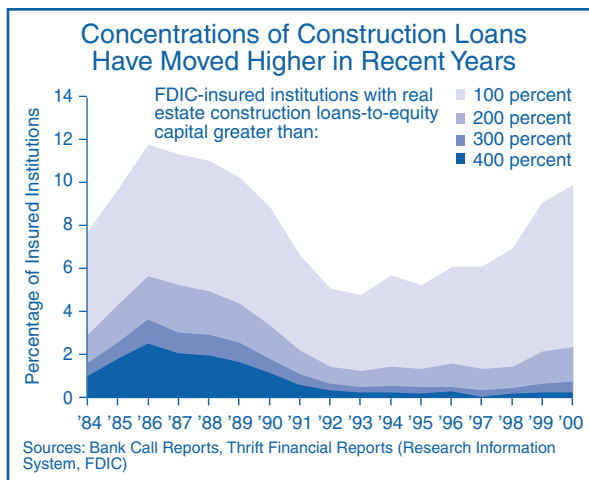
CHART 5



²⁶ Federal Deposit Insurance Corporation. *History of the Eighties—Lessons for the Future, Vol. 1: An Examination of the Banking Crises of the 1980s and Early 1990s*, Chapters 9 and 10. 1997. Washington, DC: FDIC, 1997, <http://www.fdic.gov/bank/historical/history/index.html>.

²⁷ Smith, Ray A. August 1, 2001. "Property Held by Public Firms Drops." *The Wall Street Journal*.

CHART 6



may face increased challenges to convert construction and development loans into permanent loans should the reported REIT situation become a trend and other sources of permanent capital become less available to purchase C&D loans.

Monitoring economic trends in general, and local real estate trends in particular, becomes even more important during a time of rapid change in market conditions. For example, reliance on appraisals based on outdated or top-of-market assumptions can result in a divergence between expected and realized collateral values or cash flows. Similarly, while preleasing commitments offer significant risk-reduction benefits to lenders, during a time of weakening economic conditions there is at least the possibility that a prospective tenant will be unable to honor a lease obligation, as has been the case with some firms in the high-tech sector in recent months.

Conclusion

Office market trends cannot, of course, be considered in isolation. The recent softening in office markets is a symptom of a slowing economy coupled with a rapid decline in the fortunes of some high-tech firms. Considered in this broader context, the challenge for insured institutions is simply to ensure that risk-management strategies are in place that will succeed under a more challenging economic environment.

Thomas A. Murray
Senior Financial Analyst

TABLE 2

OFFICE MARKET AND BANKING DATA ON 53 METROPOLITAN AREAS						
METROPOLITAN STATISTICAL AREA	2ND QUARTER 2001 OFFICE VACANCY	BASIS POINT INCREASE FROM YEAR END 2000	COUNT OF COMMUNITY BANKS WITH C&D LOANS	MEDIAN C&D AS PERCENTAGE OF TIER 1 CAPITAL AT 3/31/2001 (%)	HIGH-TECH AS PERCENTAGE OF TOTAL MARKET EMPLOYMENT (%)	OFFICE SPACE UNDER CONST/ STOCK AT 12/31/2000 (%)
ALBUQUERQUE	11.6	-110	9	61.0	6.8	2.0
ATLANTA	9.8	170	76	172.2	3.8	6.1
AUSTIN	11.8	680	20	53.4	10.1	9.6
BALTIMORE	8.9	60	60	22.8	3.6	6.3
BOSTON	8.7	480	100	24.1	8.2	5.6
CHARLOTTE	9.0	40	20	48.5	1.7	8.9
CHICAGO	8.9	130	225	33.5	4.5	4.9
CINCINNATI	10.1	100	58	32.6	3.1	6.0
CLEVELAND	13.6	40	16	34.8	3.0	0.8
COLUMBUS, OH	16.9	350	20	22.4	3.1	5.1
DALLAS	16.4	110	75	84.5	6.5	3.9
DENVER	12.7	370	45	70.4	5.2	4.9
DETROIT	12.0	160	28	35.2	3.1	2.8
FT. LAUDERDALE	12.8	310	13	19.1	2.7	10.2
FT. WORTH	16.4	130	36	71.8	3.4	0.7
FRESNO	14.4	20	5	196.0	0.9	0.8
HARTFORD	14.0	150	11	25.2	3.5	0.0
HONOLULU	12.6	-190	3	11.4	0.9	0.0
HOUSTON	13.6	60	48	65.8	3.1	0.8
INDIANAPOLIS	15.8	120	21	29.6	3.3	1.4
JACKSONVILLE	11.7	-20	11	65.2	1.8	3.4
KANSAS CITY	15.9	490	86	70.8	2.7	1.3
LAS VEGAS	14.5	290	19	117.7	1.5	7.3
LONG ISLAND	10.9	190	6	19.1	5.3	1.8
LOS ANGELES	14.1	150	62	35.4	3.7	2.0
MIAMI	10.5	310	26	28.1	1.8	9.2
MINNEAPOLIS	10.8	20	119	44.0	6.0	5.7
NASHVILLE	12.8	230	20	78.4	1.2	2.0
NEW YORK	5.1	230	34	10.5	2.4	1.4
NORTHERN NEW JERSEY	10.9	360	66	15.0	5.6	6.9
OAKLAND	9.3	630	12	120.0	6.5	7.9
OKLAHOMA CITY	20.3	20	44	57.8	2.6	0.5
ORANGE COUNTY	14.7	330	14	34.5	6.4	3.9
ORLANDO	13.1	110	23	72.1	2.3	8.1
PHILADELPHIA	10.7	80	68	22.1	4.5	3.2
PHOENIX	16.9	440	27	114.2	4.7	6.5
PORTLAND, OR	9.9	280	14	118.8	6.6	6.7
RIVERSIDE	14.4	-100	18	143.5	1.6	0.3
SACRAMENTO	6.6	70	11	106.9	3.9	5.6
SALT LAKE CITY	15.3	280	14	111.7	4.5	4.1

TABLE 2 (CONTINUED)

OFFICE MARKET AND BANKING DATA ON 53 METROPOLITAN AREAS						
METROPOLITAN STATISTICAL AREA	2ND QUARTER 2001 OFFICE VACANCY	BASIS POINT INCREASE FROM YEAR- END 2000	COUNT OF COMMUNITY BANKS WITH C&D LOANS	MEDIAN C&D AS PERCENTAGE OF TIER 1 CAPITAL AT 3/31/2001 (%)	HIGH-TECH AS PERCENTAGE OF TOTAL MARKET EMPLOYMENT (%)	OFFICE SPACE UNDER CONST/ STOCK AT 12/31/2000 (%)
SAN DIEGO	9.7	350	21	57.5	6.6	4.9
SAN FRANCISCO	10.3	620	21	69.0	8.3	9.7
SAN JOSE	8.1	680	5	174.5	27.4	7.5
SEATTLE	9.4	500	30	77.1	6.6	9.0
ST. LOUIS	10.1	-80	80	40.4	2.6	4.8
STAMFORD	11.2	290	10	43.5	5.6	2.6
TAMPA	14.8	70	33	40.0	4.2	2.7
TUCSON	8.8	100	3	178.4	4.4	4.8
VENTURA	14.2	270	8	49.7	5.4	14.2
WASHINGTON, DC	7.8	390	61	51.1	7.8	6.3
WILMINGTON, DE	10.4	420	12	28.4	3.8	1.6
W. PALM BEACH	12.2	160	18	37.2	2.3	4.8
WESTCHESTER	12.5	120	4	19.5	12.3	2.1
NATION	10.8	250	(1) 3,801	(1) 40.1	(2) 4.8	(2) 4.5
NOTES: ONLY COMMUNITY BANKS WITH CONSTRUCTION LOANS ARE INCLUDED IN THIS TABLE. COMMUNITY BANKS ARE INSTITUTIONS WITH ASSETS LESS THAN \$1 BILLION. NONCOMMUNITY BANKS ARE EXCLUDED BECAUSE THEIR LENDING ACTIVITIES ARE LIKELY TO SPAN A LARGER AREA THAN THE MSA IN WHICH THEY ARE HEADQUARTERED. SOURCES: TORTO WHEATON RESEARCH; BANK AND THRIFT CALL REPORTS, FDIC RESEARCH INFORMATION SYSTEM DATA; ECONOMY.COM, INC. 1. ONLY COMMUNITY BANKS WITH CONSTRUCTION LOANS AND LOCATED WITHIN A MSA ARE INCLUDED IN THESE FIGURES. 2. PERCENTAGES SHOWN ARE THE AVERAGES FOR THE 53 METROPOLITAN AREAS.						

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